

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF VIRGINIA

IN RE: . Case No. 08-35653(KRH)  
. .  
. .  
CIRCUIT CITY STORES, . 701 East Broad Street  
INC., . Richmond, VA 23219  
. .  
. .  
Debtor. . February 13, 2009  
. . . . . 11:26 a.m.

TRANSCRIPT OF EXCERPTED PORTION OF MOTION HEARING  
AGENDA ITEM 28 ONLY  
BEFORE HONORABLE KEVIN R. HUENNEKENS  
UNITED STATES BANKRUPTCY COURT JUDGE

APPEARANCES:

For the Debtor: McGuire Woods, LLP  
By: DOUGLAS FOLEY, ESQ.  
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For Lexar Media,  
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1                   MR. FOLEY: Good morning, Your Honor, the next item  
2 on the agenda is the motion by Lexar Media and Ms. Morrison is  
3 here on behalf of Lexar.

4                   THE COURT: All right. Very good.

5                   MS. MORRISON: Good morning, Your Honor.

6                   THE COURT: Good morning.

7                   MS. MORRISON: I'm Valerie Morrison representing  
8 Lexar Media. Your Honor, I have just a couple of exhibits I'd  
9 like to hand up to the Court. This is our motion for relief  
10 from the automatic stay and to compel the debtor to reject an  
11 executory contract. Your Honor, I've handed the motion, an  
12 original plus two and now I'll hand them to debtor's counsel.

13                  MR. FOLEY: Your Honor, we haven't been provided  
14 these exhibits until just now.

15                  THE COURT: All right.

16                  MR. FOLEY: So --

17                  MS. MORRISON: That's correct, Your Honor, I'm just  
18 providing them. They are the contract that was attached to our  
19 motion and let me inform the Court that it is a --

20                  THE COURT: Have you provided a copy of this now to  
21 Mr. Foley?

22                  MS. MORRISON: I'm doing that right now, Your Honor.  
23 They are simply a copy of the contract that was attached to our  
24 motion and I should advise the Court that it is a redacted

1 version. What has been redacted is the pricing, the sensitive  
2 pricing information. If Your Honor prefers that we submit an  
3 un-redacted version, we would ask the Court for leave to file  
4 it under seal and will do so after the hearing.

5 THE COURT: So your Exhibit Number 1, the consignment  
6 agreement, is the same agreement that is attached to your  
7 motion?

8 MS. MORRISON: That's correct, Your Honor.

9 THE COURT: Okay. And Exhibit Number 2 is --

10 MS. MORRISON: That's a summary statement of our  
11 estimate of -- excuse me, Your Honor -- of what we are owed  
12 post-petition as an administrative amount for goods shipped and  
13 ordered post-petition.

14 THE COURT: All right. Mr. Foley, do you have  
15 objection to the Court receiving proposed Exhibit Number 1, the  
16 redacted form of the consignment agreement?

17 MR. FOLEY: If Ms. Morrison is representing that's  
18 what was attached to the motion, we have no objection to that.  
19 Exhibit Number 2 looks like a summary and accounting. We can't  
20 stipulate to that. We don't know the accuracy of that. We  
21 haven't had a chance to --

22 THE COURT: Right. Well, I assume Ms. Morrison will  
23 have somebody testify to that and --

24 MR. FOLEY: Your Honor, just to clarify, this is on  
25 for a preliminary hearing on a motion for relief from the

1 automatic stay and a motion to compel to order compelling  
2 assumption or rejection of the contract. So I'm not exactly  
3 sure what the evidence regarding what the claim situation is is  
4 about today because we talked before the hearing. We both  
5 agreed this wasn't about resolving their claim, although I  
6 think that's really what -- that's our opposition to the  
7 motion. This is a claims reconciliation matter which doesn't  
8 need to be determined today or in the procedure in the format  
9 in which it's being raised.

10 MR. MORRISON: Your Honor, this is not a claim  
11 adjudication proceeding. However, I thought it would be  
12 helpful for the Court to understand just approximately how much  
13 was shipped post-petition and is owed to my client for  
14 post-petition goods on an administrative basis. Although we're  
15 not seeking to determine the claim today, what we're asking the  
16 Court to do is allow us to terminate this contract to cut off  
17 liability heading back to the estate which could affect the  
18 amount of the claim.

19 So it's not the essential issue of the case, but it  
20 is something I wanted the Court to be aware of, roughly our  
21 estimate of what we believe we're owed. It's still subject to  
22 further reconciliation and we have not filed a request from  
23 haven of administrative expense claim yet. But we will -- we  
24 anticipate doing so in the future. So -- but we are not asking  
25 for adjudication of our claim today. This is really more by

1 way of information to the Court and our estimate of what's  
2 owed.

3 THE COURT: All right. And the -- you're asking for  
4 relief from stay to be able to terminate this contract. Why  
5 isn't this a 365 matter as opposed to a 362 matter?

6 MS. MORRISON: Your Honor, we did ask the Court to  
7 grant us relief from the stay to terminate the contract and  
8 also compel the debtor to reject because the debtor has  
9 breached post-petition and is no longer ordering goods and, in  
10 our opinion and I hope to convince the Court of this, is not  
11 able to assume this contract. And when -- I think it's fairly  
12 well-settled in this jurisdiction that when a contract is not  
13 capable of assumption, there is plenty of authority for the  
14 proposition that it's appropriate to grant relief from the  
15 automatic stay. And why this is key to us, Your Honor, is that  
16 there is a unique provision of this contract. In fact, it  
17 might be helpful to actually take a look at it. Again, it's  
18 Exhibit 1, Your Honor.

19 And by way of background, let me start with at what  
20 this contract was. Your Honor, Lexar is a manufacturer of  
21 flash cards and junk drives. The parties entered into a  
22 consignment agreement on November 5th of last year, just a  
23 couple of days before the bankruptcy was filed. And, in  
24 essence, what the contract provided was for Lexar to supply  
25 goods on consignment for resale by Circuit City in its retail

1 operations.

2           Under the contract, the debtor submitted purchase  
3 orders for consigned goods that it wants to purchase and Lexar  
4 has the ability to accept or the discretion to reject any  
5 purchase order. Once a purchase order was accepted, Lexar  
6 would ship the goods at an agreed price pursuant to the terms  
7 of the contracts. Payments for these goods were made upon sale  
8 to the ultimate consumer because this was a consignment  
9 agreement. So title was retained in Lexar until sale  
10 ultimately through to the consumer. And payments were remitted  
11 daily.

12           In addition, Your Honor, the contract requires the  
13 debtor to provide several reports including inventory reports,  
14 sales reports and monthly sales tax reports to enable Lexar to  
15 monitor the sales as they are sold through to the customer and  
16 determine how much is owed and, also, because Lexar retained  
17 title to the property, to the goods, to determine what personal  
18 property tax liabilities it may have.

19           Now, Your Honor, pursuant to this agreement, the  
20 debtor did, in fact, submit several post-petition purchase  
21 orders which Lexar accepted and delivered the goods to Circuit  
22 City on credit post-petition. And what the statement which is  
23 Exhibit 2 is purporting to show is that my client is --

24           THE COURT: Well, now, I've admitted Exhibit 1, but  
25 there's been an objection to Exhibit 2 so you'll need to --

1 MS. MORRISON: That's right. We will put on our  
2 evidence of that, Your Honor. I do have a witness present in  
3 the courtroom, Mr. Brad Gray (phonetic) who will testify to  
4 that if we're permitted to proceed. But, in any event, Lexar  
5 has advanced on credit in terms of goods and amounts owed,  
6 approximately \$2,013,000 at this point, Your Honor.

7 Now, the unique provision of this contract is the  
8 requirement or provision for the payment by Lexar of marketing  
9 and slotting fees. And it's not exactly a payment, but it is a  
10 credit against Circuit City's payments to Lexar for the amount  
11 of these marketing and slotting fees. This is set forth in  
12 Exhibit C to this contract, Your Honor. And the amount of the  
13 fees is broken down in monthly payments of \$625,000 each. But  
14 the payments are for an entire year and front loaded to the  
15 first four months. So, in other words, \$625,000 a month for  
16 four months applicable for advertising and marketing and  
17 slotting fees for the entire year.

18 Now, marketing fees are advertisements. The parties  
19 had an agreement pursuant to which Circuit City would advertise  
20 in their weekly circular that was distributed as part of a  
21 Sunday newspaper ad to 38 million households in the area. And  
22 there were other advertisements, as well. The slotting fees  
23 are for real estate in the store. The -- Lexar's goods, the  
24 memory cards and the junk drives are hung on pegs that are  
25 located in the store. So the slotting fees are in payment of

1 that. And, again, they're front loaded to the first four  
2 months, but applicable to the entire year of the contract, the  
3 entire year term.

4 Now why is this important or why is termination  
5 important? Your Honor, there is a provision a provision at the  
6 end of each segment of Exhibit C to this contract which talks  
7 about what happens on termination of the contract and it's an  
8 identical provision. It's the last sentence of both the MDF or  
9 Marketing Development Fund section and the slotting fee section  
10 and I'll read it. The slotting fees will not be repaid upon  
11 the return of consigned product hereunder provided. However,  
12 as the slotting fees represent payment for slotting usage  
13 throughout the initial term of the agreement, in the event the  
14 agreement is terminated prior to the expiration of the initial  
15 term, and the initial term is the 12-month period that  
16 commenced November 5th, 2008, Circuit City shall refund to  
17 Lexar a pro rata portion of the slotting fees previously paid  
18 by Lexar and Circuit City. Identical provision appears for the  
19 marketing and development funds.

20 So, Your Honor, as I interpret this, for example, if  
21 we were 45 days into the contract, roughly 13 percent of the  
22 annual fees would be credited against the amounts owed to Lexar  
23 on Circuit City's invoices and the balance would no longer be  
24 an obligation to be paid because 13 percent is the product of  
25 45 over 365 days. As it is -- as of the date we filed our

1 motion on January 28th, and we have asked that relief be  
2 granted retroactively, we were 84 days into the contract. That  
3 turns out to be 24 percent of the contract and would result in  
4 a credit against the amounts owed to Lexar of \$600,000. This  
5 has a value to Lexar of \$6,761 a day. So every day that goes  
6 by that this contract is not terminated, my client loses close  
7 to \$7,000 or potentially loses close to \$7,000 determining --  
8 depending on exactly how this provision is ultimately  
9 interpreted by the Court.

10 Now, the debtor's position here is what the -- what  
11 is the rush. You know, we have until plan confirmation to  
12 assume or reject. We need time to decide. And I just  
13 explained what the rush is, Your Honor. If we are not  
14 permitted to terminate the contract, Lexar is exposed to a  
15 depletion, if you will, of its administrative claim for goods  
16 sold on post-petition credit as the rate of just under \$7,000 a  
17 day.

18 But, you know, critically, Your Honor, the argument  
19 that the debtor needs more time to evaluate this contract is in  
20 my view a red herring because the debtor has no ability and no  
21 intention to assume this contract. And that's without even  
22 addressing the question of whether the debtor has the ability  
23 to cure the substantial default of \$2 million, perhaps with a  
24 credit of 600,000. The debtor is out of business. The debtor  
25 is winding down its affairs. The debtor is not -- this is not

1 a situation where the debtor is going to order more inventory.  
2 I can't imagine that the debtor is authorized to order more  
3 inventory. The point is the debtor doesn't need this contract  
4 for the purpose for which it was intended which is to be a  
5 source of supply of memory and flash cards for the debtor in  
6 the ordinary course of its operations. The debtor is  
7 liquidating its inventory, liquidating its furniture, fixtures,  
8 equipment and leases. The contract is of no value and this  
9 fact is not disputed by Circuit City.

10 The only other possibility is that the debtor might  
11 find some value in this contract and want to assume it and  
12 assign it to a third party and create some value for the  
13 benefit of the estate. But that, too, Your Honor, is a hollow  
14 and illusory argument if the debtor intended to make it. Why  
15 is that? Well, first, under the terms of the contract -- and I  
16 point the Court to section -- excuse me -- Paragraph 3B. If  
17 Your Honor takes a look at Paragraph 3B, you will see that  
18 under the express terms of the contract Lexar has no obligation  
19 to accept purchase orders from Circuit City and has complete  
20 discretion to reject any purchase order. "All purchase orders  
21 are subject to acceptance by Lexar via ED1855" -- which is a  
22 computer program pursuant to which purchase orders were  
23 transmitted -- "and Lexar shall have no liability to Circuit  
24 City with respect to purchase orders that are not accepted."

25 Secondly, Paragraph 22 of this contract, 22A. And

1 this is a key point, Your Honor. This contract is terminable  
2 by either party without cause, liability or obligation on 60  
3 days notice. So what have we got? We've got a contract under  
4 which my client is under no obligation to accept any orders of  
5 any kind and we've got a contract that's terminable at will  
6 without cause, liability or obligation on 60-day notice -- 60  
7 days notice. We have a contract that has no potential value to  
8 anyone. There is nothing here for this estate to assume or  
9 assign.

10 So where are we? We're back at the fact that Lexar  
11 faces the possibility of losing \$7,000 a day while the debtor  
12 determines whether it wants to assume or reject a contract that  
13 it has no ability or intention of assuming or assigning.  
14 There's just absolutely no business purpose to be accomplished  
15 by delay, by holding this contract out. My client extended  
16 credit to Circuit City in good faith post-petition. You know,  
17 unfortunately, like so many vendors it gets caught up.  
18 However, it should not have its claim depleted by an artifice,  
19 by an artificial need to evaluate a contract that has no  
20 commercial value to anyone anywhere.

21 Your Honor, I'd cite for the Court the TechDyn case  
22 which is a case from Judge Mitchell at 235 BR 857 which stands  
23 for the proposition that relief from the automatic stay is  
24 absolutely appropriate when a contract is not capable of being  
25 assumed, as we have here. The facts were different there.

1 That was a case where a contract as a matter of law was not  
2 capable of being assumed because it was -- I believe it was a  
3 patent license and, therefore, was not assignable under  
4 applicable federal law. But the same principle applies here,  
5 although we're dealing with a commercial reality as opposed to  
6 a legally non-assignable contract.

7 We have another breach by the debtor which I believe  
8 is uncontested. There's a specific provision of this contract,  
9 Paragraph 22B, which requires the debtor to continue operating  
10 its retail business in the ordinary course. And this is a  
11 material term of the contract which is in breach and I don't  
12 believe that the debtor in any meaningful way or realistic way  
13 would attempt to refute or contest the fact that it is out of  
14 business, that it's not operating currently in the ordinary  
15 course of business.

16 Now, the debtor has argued in its papers that this is  
17 an ipso facto clause. But, in fact, it's not an ipso facto  
18 clause. There may be other ipso facto clauses in this  
19 contract, but an operations clause, the requirement that the  
20 company remain operating as a retail enterprise as a going  
21 concern, that has nothing to do with the financial condition of  
22 the debtor. And it has nothing to do with the fact that the  
23 debtor has filed for bankruptcy. In fact, as I mentioned, my  
24 client entered into this contract a few short days before the  
25 bankruptcy. After the bankruptcy, it continued to sell on

1 credit to Circuit City and it continued to do this without ever  
2 threatening to terminate in the hopes that Circuit City would  
3 survive. And you'll hear testimony to that effect if we're  
4 allowed to put our witness on.

5           What caused my client to want to terminate this  
6 contract was when the debtor decided it was going out of  
7 business. That and the fact that the debtor stopped paying. I  
8 do have a witness present in court. There are several other  
9 defaults which, you know, obviously, we would need testimony to  
10 establish, but the debtor's not advertising the way it said  
11 that it would and it's not reporting the way that it said that  
12 it would. For these reasons, we'd like to be able to proceed,  
13 although I do believe that if this Court deems this a  
14 preliminary hearing, there is enough based on the four corners  
15 of the contract and without evidence for the Court to rule that  
16 there is nothing here to assume or assign and, therefore, the  
17 stay should be lifted as a matter of law.

18           THE COURT: All right. Thank you. Mr. Foley?

19           MR. FOLEY: Your Honor, I think Ms. Morrison got into  
20 the real heart of what she wants toward the end of her argument  
21 where she said what she's concerned about is claim depletion.  
22 That's what she's -- that's what this motion is really all  
23 about. It's an accelerated effort to determine the amount of  
24 Lexar's administrative claim in this case. What she didn't  
25 tell you is that Lexar is not a perfected consignment vendor in

1 this case. There is no perfection documents. They don't want  
2 the goods back. They don't want us to escrow the sale proceeds  
3 from their goods and have it determined at the end of the sale  
4 process. We've offered that. That's not what they want.

5           What they want is for you to order today that they  
6 effectively terminated the contract on January 26 so they can  
7 summarily eliminate a credit that the estate would otherwise  
8 have been entitled to that arose on January 31 in the amount of  
9 \$625,000. Yes, the MDF credits and the slotting fee credits  
10 which go back and forth between the parties and the amounts  
11 that we owe them for goods and its all netted out and paid in  
12 the ordinary course when we're -- you know, if we weren't in  
13 bankruptcy. Yes, those are front loaded. Are there operation  
14 provisions in the contract as to how much of those we're  
15 entitled to at the end of the day? Yes.

16           But what this is is a claim reconciliation issue.  
17 There is absolutely no reason to have that determined today.  
18 They're not selling us anymore goods. They're not paying us  
19 anything for these credits. She's saying they're suffering a  
20 penalty of \$7,000 a day. Well, this is claim resolution  
21 process. We will resolve this as part of the claim process.  
22 We are selling the goods under the agency agreement. We're  
23 getting -- the estate's getting a benefit for selling the  
24 goods. The e-mail that they receive about the lack of  
25 reporting, as Your Honor is aware, the headquarters personnel

1 was drastically reduced after January 16th. The e-mail that  
2 they received was somebody who was laid off. We can and we  
3 have confirmed this morning that we can give them accurate  
4 reporting at the conclusion of the sale process which will  
5 occur by the end of March.

6           And we would ask the Court to simply carry this  
7 matter over for a final hearing and we will try to resolve it  
8 beforehand and/or develop the factual record before the March  
9 30th hearing date because as a factual matter she wants you to  
10 determine today that we are entitled to no more credits after  
11 January 26 because we started going out of business sales.  
12 Well, the facts may be that we sold every one of their products  
13 exactly where it was supposed to be in the store pursuant to  
14 the -- our entitlement to the slotting agreement, the slotting  
15 fees, and that the advertising may have actually occurred in  
16 the way it was supposed to occur. And then, you know, we've  
17 actually -- the estate actually may have some entitlement to  
18 some credits post January 26. And so we can't determine those  
19 factual issues today.

20           We're going to try to negotiate with them and resolve  
21 it and see if we can do that. But we would ask the Court to  
22 carry both these matters over to March 30th for a final  
23 evidentiary hearing. We'll take depositions beforehand if we  
24 have to, but we're going to try to resolve this. We will  
25 voluntarily give them sales reporting information real time if

1 they want it. But the sale, we think it makes sense to do it  
2 at the end of the sale process which should end some time in  
3 the middle of March. And that way we'll know exactly what  
4 we're dealing with and hopefully we can resolve it by then.

5 THE COURT: All right. Thank you.

6 MS. BERAN: Your Honor, although the Committee did  
7 not file a formal objection to this pleading, the Committee has  
8 been in consultation with the debtor and the debtor's handling  
9 on this and it is in support of the debtor's position. In this  
10 instance, the Committee is concerned that the Court, in  
11 essence, would be resolving an administrative expense claim  
12 today with -- on a very short time table without any type of  
13 discovery and without even time to review.

14 Based on that and based on the debtor's suggestion of  
15 potentially putting proceeds in an escrow and having all  
16 parties' rights reserved, we believe it's most appropriate for  
17 this Court to deny without prejudice for refiling this pleading  
18 today and the next alternative, as suggested by Mr. Foley,  
19 would be to set this matter down for final hearing. We believe  
20 all parties' rights could be preserved and that would allow the  
21 debtor and its management to focus on really the critical  
22 aspect of what it needs to focus on right now and that's in  
23 maximizing the value of its assets for the benefit of all  
24 parties in interest in this case.

25 THE COURT: Thank you, Ms. Beran. Ms. Morrison, it

1 is -- it's not the Court's procedure to hear evidence in a  
2 preliminary hearing. The Court -- if there's going to be  
3 evidence on a motion for relief from stay, sets the matter down  
4 for a final hearing so that everyone can be prepared to put  
5 forth their evidence. And I'm not going to dismiss your motion  
6 for relief from stay as was suggested by Ms. Beran, but I am  
7 going to set it down for a final hearing so that we can have  
8 some facts if there is cause, as I understand your argument to  
9 be, to terminate the automatic stay, if 362 is applicable to  
10 executory contract under Section 365 which I'm not saying it  
11 is. Just -- but those are the issues as I understand would  
12 need to be resolved at the final hearing.

13 MS. MORRISON: Your Honor, I would simply ask that  
14 the Court set this as quickly as possible because we do  
15 perceive the danger of, again, a draining of the administrative  
16 claim of \$7,000 a day which adds up very quickly. So we would  
17 just simply ask that if Your Honor is inclined to set this for  
18 final hearing that it be set as quickly as possible.

19 THE COURT: The -- let me drill down on that a little  
20 bit. If the debtor is not doing what -- and you're able to  
21 show that the debtor is not doing what they're supposed to be  
22 doing under the terms of the contract, why would be they  
23 entitled to the credit?

24 MS. MORRISON: I would agree with that  
25 wholeheartedly, Your Honor.

1           THE COURT: And if they are doing what they're  
2 supposed to be doing, then they should be entitled to the  
3 credit. So I don't understand why the timing makes any  
4 difference as far as that's concerned. It's --

5           MS. MORRISON: There --

6           THE COURT: That's a factual issue which seems to me  
7 more important thing is to find out what the facts are. Are  
8 they doing it or are they not doing it? And rather than  
9 putting it on a fast track, we ought to do it on a regular  
10 track so that the, you know, the evidence can be developed.

11          MS. MORRISON: All I would say in response to that,  
12 Your Honor, is this is an unusual contract. It's an unusual  
13 provision. The pro rata application may be susceptible to an  
14 interpretation that requires termination in order for the pro  
15 rata to kick in, the pro rata reduction to kick in. And if  
16 that's the case, with that hanging out there, there is still an  
17 exposure or a risk that this contract could be interpreted that  
18 way and my client could be facing a loss of \$7,000 a day. If,  
19 on the other hand, the contract is not susceptible to such an  
20 interpretation and I know Your Honor is probably not going to  
21 rule on this right now to give us some comfort.

22          THE COURT: I'm not. You're safe.

23          MS. MORRISON: Given that probability or given that  
24 possibility that it's susceptible to that interpretation,  
25 there's still the risk out there. And that's why we're asking.

1 That's why we moved on an emergency basis. That's why we're  
2 asking the Court to consider this on an expedited scheduling if  
3 at all possible.

4 THE COURT: All right. Mr. Foley, can we agree on a  
5 date for a final hearing?

6 MR. FOLEY: Your Honor, as Your Honor is aware, we  
7 have several hearings coming up that are pretty full. That's  
8 why I suggested the March 30th date. And, again, I think Your  
9 Honor was correct about the timing issue. If Your Honor  
10 determines that at some point in time, you know, we were not in  
11 compliance and not entitled to credits, you can effectuate the  
12 relief that she's seeking by saying that, you know, she's not  
13 prejudiced by the fact that the matter is heard at a later  
14 date. Again, this is a claim reconciliation matter. She's  
15 talking about \$7,000 a day, but Your Honor gets to decide that.  
16 Your Honor gets to decide whether we are entitled to credits  
17 after a certain period of time.

18 THE COURT: And I agree with that. I think I can  
19 resolve that so that there wouldn't be any prejudice no matter  
20 when we heard it. But -- so I'm going to set it down then for  
21 the March 30 omnibus hearing date. And that will be then an  
22 evidentiary hearing so you'll need -- both parties need to be  
23 prepared.

24 MR. FOLEY: Yes, Your Honor.

25 UNIDENTIFIED ATTORNEY: Thank you, Your Honor.

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\* \* \* \* \*

**C E R T I F I C A T I O N**

I, KELLI R. PHILBURN, court approved transcriber, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter, and to the best of my ability.

/s/ Kelli R. Philburn  
KELLI R. PHILBURN  
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